TORYS

Hydro One Prospectus Process: Briefing Note

Torys LLP

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[NTD: Cross references to relevant sections of prospectus to be added]

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Background

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- The Province is proceeding to broaden the ownership of Hydro One through the sale of a portion of its shares
- As contemplated by the Electricity Act amendments, this will be done through a new holding company, Hydro One Limited (HOL) which was formed on August 31, 2015
- HOL will file a prospectus in all Canadian provinces and territories to undertake an “Initial Public Offering by Secondary Offering”
- Prior to the completion of the offering process, a reorganization will be completed to create the new Hydro One corporate structure

Hydro One Limited (HOL)

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- HOL has the same board and executive management team as Hydro One Inc.
- HOL is wholly-owned by the Province, but until the reorganization, it has no assets
- HOL will be the "issuer" in the offering, even though it issues no shares. It will file the prospectus to allow the Province's sale of shares
  - Province is "selling shareholder"
  - Hydro One Inc. is "promoter" as the existing underlying issuer whose disclosure is included in the prospectus

The Structure and Reorganization

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- The prospectus for the offering generally describes how Hydro One and the Province's ownership interest in the Hydro One companies <u>will be</u> at the time the offering is completed
- A reorganization will occur prior to completion, under which:
  - the Province's common shares and preferred shares of Hydro One Inc. are exchanged for common shares and preferred shares of HOL
  - the Province uses the agreed departure tax payments to purchase more HOL common shares
  - HOL becomes the owner of Hydro One Inc. and its subsidiaries
  - the Province, prior to the offering, is the sole shareholder of HOL

Hydro One Limited Prospectus Requirement

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- Under Canadian securities law, a prospectus is required for the sale of shares from the holdings of a “control person”
- The Province is a control person of Hydro One, as it holds more than 20% of the common shares of Hydro One
- Even though the Province is the seller of shares, the prospectus must be prepared and filed by the issuer, HOL
- HOL will be using the Post-Receipt Pricing (PREP) procedures for this offering, which allow it to file a final prospectus and obtain a receipt before the offering is priced

Hydro One Limited Prospectus Requirement (cont'd)

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- The draft preliminary base PREP prospectus has been prepared by Hydro One Inc., and its management team (including business group leaders responsible for operations/business units), with the assistance of Hydro One's counsel, Oslers
  - financial statements included in the prospectus have been audited or reviewed by Hydro One's auditors, KPMG
  - comments on drafts have been provided over the past two months by staff at the Ministries of Energy, Finance, Attorney General, as well as OFA and the Province's external counsel, Torys
  - the lead book runners and their counsel, Blakes, are also actively engaged in the prospectus drafting process

Hydro One Limited Prospectus Requirement (cont'd)

- This working group will continue to be engaged through the regulatory review process, and in the preparation of the subsequent prospectus filings
- Hydro One has undertaken a review of its contracts to ensure no change of control provisions or similar triggers will result from the offering
- The underwriters and their counsel will undertake a "due diligence" review of business and legal matters related to Hydro One - building on their work related to previous Hydro One Inc. debt offerings - in connection with the offering

Offering Parameters

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- The offering under the prospectus will include a “base offering” of approximately 13.6% of the Province’s common shares of HOL
- An additional 1.36% of the Province’s common shares (10% of the base offering) will be available to the underwriters for purchase up to 30 days post-offering, to support the market – an “over-allotment option”
- The Province’s sale of common shares to trusts for the PWU and The Society will occur on the closing, but those sales are not covered by the prospectus

Prospectus Disclosure Requirements

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- The prospectus includes specific, detailed disclosure about the Hydro One companies, their business and the shares being offered
- It must provide "full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed"
  - a "material fact" means a fact that would reasonably be expected to have a significant effect on the market price or value of those securities
- The prospectus must contain
  - general business and financial information about Hydro One
  - information about the Hydro One management team and the governance arrangements with the Province
  - details on the terms of the common shares being sold
  - risk factors associated with an investment in the common shares
  - an offering price range (in the amended and restated preliminary prospectus)
- Disclosure must be true and accurate as of the date of filing of the prospectus
- Certification and liability obligations are described below

Prospectus Timeline

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A. IPO Preparation April-July 2015	B. IPO Process June-Sept 2015	C. IPO Marketing/ Closing Fall 2015
• Lead: Province • Leadership changes to appoint “public company ready” Board and Chair • Select key parties involved including lead bookrunner to support the process by competitive process, overseen by process advisor Denis Desautels • Legislative changes to provide authority and structure for a new public company	• Lead: Hydro One, Scotiabank and RBC Capital Markets • Determine underwriting syndicate • Conduct due diligence and develop preliminary prospectus and other supplementary agreements • File preliminary prospectus with the Ontario Securities Commission (OSC) and other regulators	• Lead: Hydro One, Scotiabank and RBC Capital Markets • Conduct investor road shows to provide potential investors with required information to access offering across Canada and in other jurisdictions • Complete regulatory reviews and clearances • IPO is expected to close in October/early November

Prospectus Timeline (cont'd)

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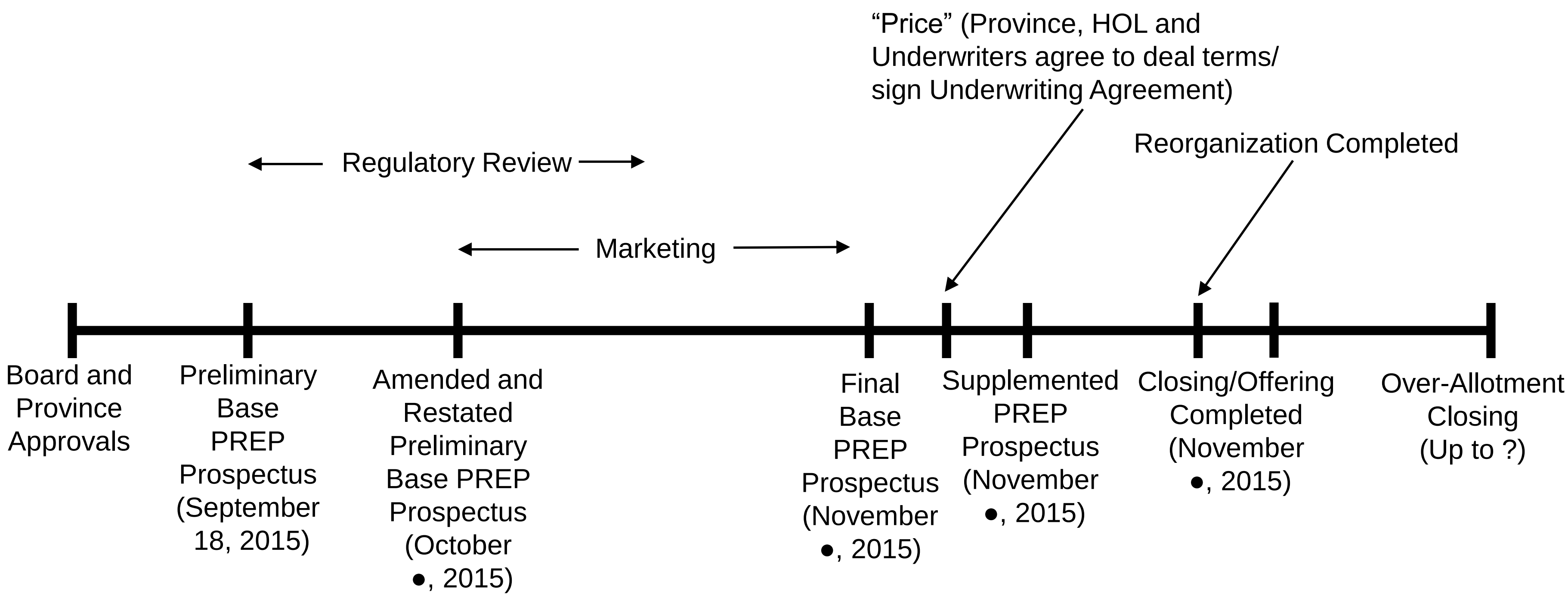
[NTD: Dates to be added when schedule finalized.]



Prospectus Timeline (cont'd)

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- Plan to file the preliminary base PREP prospectus with the Canadian securities regulators on September 17, to obtain a clearance ("receipt") prior to technical briefing on the morning of September 18
- OSC will lead the review, and will provide written legal and accounting comments after 10 business days
- Hydro One will coordinate a written response, after which additional/follow up questions and responses will be exchanged
  - correspondence is not publicly available
  - interested parties could make public statements about prospectus or forward comments to the OSC, which may ask Hydro One and the Province for responses

Prospectus Timeline (cont'd)

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- Once most significant comments are resolved with the OSC, these will be reflected in the amended and restated base PREP prospectus
  - underwriters will use this document, and commence formal sales process
  - underwriters' sales network will promote the offering to clients
  - Hydro One management and underwriters will commence a "roadshow" – meetings/presentations to the sales network and potential large/institutional buyers

Prospectus Timeline (cont'd)

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- Once regulatory comments are resolved, and just ahead of the pricing of the offering, a final base PREP prospectus is filed – it contains the final, settled version of the disclosure except for information relating to the offering price and size
  - this completes the regulatory review process
- After pricing and entry into the underwriting agreement (discussed below), the remaining information is added and the final supplemented PREP prospectus is filed, and delivered to purchasers
  - this is the formal liability document for the offering

Prospectus Timeline (cont'd)

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- The active purchase and sale of the shares will be completed five business days after pricing (a market convention)
  - Province sells to underwriters, who on-sell to purchasers
  - trading commences on the TSX
- The reorganization steps will be completed starting one or two days before the closing, including the departure tax transactions and the transfer of the Hydro One companies to HOL

Underwriting Agreement

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- A price range for the offering will be included in the amended and restated preliminary prospectus
- As the marketing efforts progress, the underwriters (led by Scotiabank and RBC Capital Markets) will solicit expressions of interest from investors and engage in a "book-building" process: how much demand at what price point
- On the date selected for pricing, representatives of the Province and the underwriters will verbally agree to an offering size and price
- After the closing, the underwriters will support the trading of the shares in the market by selling additional shares to purchasers – they can source those shares in the market, stimulating demand, or ultimately, by acquiring those shares from the Province through the over-allotment option

Underwriting Agreement (cont'd)

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- These terms – and other representations, warranties and commitments of the Province (as selling shareholder), HOL (as issuer), HOI (as promoter) and the underwriters will be reflected in the underwriting agreement
- The underwriting agreement will set out the respective legal obligations of Hydro One, the Province (as selling shareholder) and the underwriters in connection with the offering
- The underwriters will agree to purchase the common shares of HOL from the Province at the agreed price, to be specified in the supplemented PREP prospectus

Underwriting Agreement (cont'd)

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- Key terms in the underwriting agreement will include:
  - the underwriters' obligation to purchase the common shares
  - the over-allotment option that allows the underwriters to purchase additional common shares in connection with market support activities
  - terms related to the underwriters' distribution obligations, including the offering price and jurisdictions in which the common shares will be sold
  - representations, warranties and covenants made by HOL, HOI or the Province
  - the representations and warranties of the Province relate to matters generally within its control, including title to the shares, and not to the business of Hydro One
  - indemnity and contribution provisions
  - conditions on the underwriters' obligations to complete the IPO
  - commissions payable to the underwriters and expense allocations (including between HOL, HOI and the Province)
  - termination rights in favour of the underwriters
  - lock-up provisions that restrict HOL, members of management and the Province from selling additional common shares for 180 days following closing

Communications Protocols

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- Under securities laws, the “quiet period” restrictions on communications continue through to the sale of the over-allotment shares
  - during the quiet period, communications that might be seen as being in furtherance or promotional of Hydro One or the offering are restricted
  - Energy and the Province’s communications team will need to continue to monitor and script any public comment
  - after the prospectus is filed, any material statements or information about Hydro One that are not included in the prospectus can trigger regulatory concerns
  - commenting on the prospectus disclosure, or responding to any adverse commentary, should be undertaken carefully

Prospectus Liability

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- The prospectus will be filed with a certification, at this date, that it contains "full, true and plain disclosure of all material facts relating to the securities offered"
- This certification will be provided by:
  - Hydro One Limited, as issuer (CEO, CFO and two directors)
  - Hydro One Inc., as promoter (CEO, CFO and two directors)
  - Her Majesty the Queen in Right of Ontario, as represented by the Minister of Energy, as selling shareholder
  - Each of the underwriters will provide a similar certification, qualified "to their knowledge"
- Although this certification is made – and must be accurate – at the time each prospectus is filed, investors' rights are based on any disclosure in the supplemented base PREP prospectus that will be filed later in the process after the OSC review is completed

Prospectus Liability

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- Liability is triggered by a “misrepresentation” giving rise to an investor loss (damages)
  - an untrue statement of a material fact
  - an omission to state a material fact necessary to make the prospectus not misleading
- In addition to the parties that provide certifications, each of the CEO, CFO and the directors of HOL is subject to personal liability for a misrepresentation, and auditors and lawyers are liable for any misrepresentation by their audit reports or legal opinions

Prospectus Liability (cont'd)

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- If the prospectus contains a misrepresentation: choice of two statutory rights for a purchaser under the prospectus:
  - a purchaser can sue for damages, up to the purchase price; or
  - a purchaser can return the shares and have the purchase price refunded
- Purchaser is deemed to have relied on the misrepresentation
  - this facilitates investor claims, including by class action

Selling Shareholder Liability for Prospectus Disclosure

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- The Province, as selling shareholder, would typically be liable under securities legislation together with Hydro One for any misrepresentation in the prospectus
- Liability is strict: there is no due diligence defence for the selling shareholder or the issuer, unlike in the case of the directors of Hydro One and the underwriters
- Joint liability would be apportioned on a “just and equitable” basis by a court
  - allocation of liability would likely turn on a number of factors, including relative responsibility for the misrepresentation and relative benefit received from the offering (i.e., the proceeds)

Crown Immunity in Hydro One IPO

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- The Province benefits from immunity from statutory liability under securities legislation in Ontario and Newfoundland and Labrador
- The Province is expressly liable under Saskatchewan law
- Other provincial and territorial statutes are silent on the point: although the Crown is generally not bound by legislation unless explicitly named, there are strong arguments that it would nevertheless be bound because it is taking advantage of the relevant legislation
- Courts in Ontario may refuse to enforce judgments obtained in other provinces and territories under their securities legislation, but we think that is unlikely

Crown Immunity in Hydro One IPO (cont'd)

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- In the proposed 2002 offering, the Province proposed to rely on its Crown immunity
- The Province plans to rely on its immunity in this IPO, and will not provide indemnification with respect to the prospectus disclosure to the underwriters, who will rely on an indemnity solely from Hydro One
- Investors in the offering would continue to have recourse against other potentially liable parties, principally Hydro One (financially capable of responding to and discharging any claims)

Key Prospectus Sections

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- Prospectus sections of particular interest to the Province include:
  - Electricity Industry (explaining Ontario's electricity sector and key players)
  - Business of Hydro One, particularly:
    - Investment Highlights
    - Operations – Employees and Outsourced Services
    - Pre-Closing Reorganization
  - Management's Discussion and Analysis - Outlook
  - Principal and Selling Shareholder (including PWU/Society and potential Aboriginal share ownership)
  - Departure Tax
  - Governance and Relationship with Principal Shareholder
  - Risk Factors, particularly:
    - Risks Relating to Hydro One's Business and the Industry
    - Risks Relating to the Company's Relationship with the Province

Key Prospectus Sections (cont'd)

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- Risk factors are likely to be a challenging communications item for the Province
  - securities laws require explanation of potential bad news risks material to the issuer and its business that a reasonable investor would consider relevant to an investment in Hydro One, ranked by seriousness
  - risks are not to be de-emphasized or mitigated with softer language
  - they are intended to help rebut future misrepresentation claims there is no omission, as we alerted you to this potential risk
  - we believe this presentation of risks is appropriate for an equity IPO, and it has been reviewed by representatives of the Council and the communications team, in addition to the full prospectus working group

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